

VZCZCXRO4578  
PP RUEHDBU RUEHFL RUEHKW RUEHLA RUEHNP RUEHROV RUEHSL RUEHSR  
DE RUEHMO #2765/01 3141457  
ZNY CCCCC ZZH  
P 101457Z NOV 09  
FM AMEMBASSY MOSCOW  
TO RUEHC/SECSTATE WASHDC PRIORITY 5357  
INFO RUCNCIS/CIS COLLECTIVE PRIORITY  
RUEHZL/EUROPEAN POLITICAL COLLECTIVE PRIORITY  
RUEHXL/MOSCOW POLITICAL COLLECTIVE PRIORITY  
RUEHKV/AMEMBASSY KYIV PRIORITY 0389  
RHEHNSC/NSC WASHDC PRIORITY  
RHMFISS/DEPT OF ENERGY WASHINGTON DC PRIORITY  
RUCPDOG/DEPT OF COMMERCE WASHDC PRIORITY

C O N F I D E N T I A L SECTION 01 OF 02 MOSCOW 002765

SIPDIS

DEPT FOR EUR/RUS, EEB/ESC/IEC GALLOGLY AND GREENSTEIN,  
S/EEE MORNINGSTAR  
DOE FOR HEGBURG, EKIMOFF  
DOC FOR JBROUGHER  
NSC FOR MMCFAUL

E.O. 12958: DECL: 11/09/2019

TAGS: [EPET](#) [ENRG](#) [ECON](#) [PREL](#) [RS](#)

SUBJECT: DESPITE USD 6 BILLION 2Q09 PROFITS, GAZPROM FACES  
SERIOUS CHALLENGES; RECEIVES UKRAINIAN PAYMENT ON TIME

REF: MOSCOW 2277

Classified By: Economic Minister Counselor Matthias J. Mitman, Reasons  
1.4 (b,d)

-----  
SUMMARY  
-----

¶1. (C) Gazprom announced a doubling of its profits in the second quarter of 2009 following anemic first quarter earnings. However, falling demand as well as rising operational costs and debt pose longer-term challenges to the company's competitiveness. Experts warn that more efficient companies will exert downward pressure on Gazprom's profitability in the future. Also defying negative predictions, Ukraine paid its October gas bill on time. Russian officials confirmed their decision not to impose fines on Ukraine for purchasing less than the contracted volume of gas as long as "crisis conditions" continue in Ukraine. End Summary.

-----  
GAZPROM INCREASES PROFITS DESPITE FALLING SALES  
-----

¶2. (SBU) Gazprom improved on its first quarter performance in the second quarter of 2009, although lower demand and rising operating costs continued to hamper profits. While down 48 percent year-on-year, Gazprom recorded a net profit of more than USD 6 billion in the second quarter, double the amount earned in the first quarter (Note: Low European demand and a three-week suspension over the dispute with Ukraine contributed to poor first quarter performance. End Note.) Despite a 69 billion cubic meter drop in the overall volume of gas sold in the first half of the year, net revenues from sales rose two percent year-on-year owing to an increase in gas prices in Russia and overseas. Sales to CIS states suffered a notable 57 percent fall in volume. In addition, Gazprom's operational expenses rose by USD 5.8 billion, or 16 percent, year-on-year from January to June. In particular, expenses for gas purchased from Central Asia doubled.

¶3. (SBU) Experts predicted a positive fourth quarter result for Gazprom but warned that its rising operational expenses and debt had begun to erode the company's competitiveness. Alexander Nazarov, an analyst at the Metropol investment group, commented to the press that the fourth quarter would

be better for Gazprom because demand would continue to rise through the end of the year. However, East European Gas Analysis Director Mikhail Korchemkin told Kommersant that the company's growing operating costs could become a significant problem in terms of its competitiveness. Korchemkin noted that Gazprom's extraction expenses per thousand cubic meters rose 21 percent in comparison with the first quarter of this year, while its transportation costs increased by 20 percent.

Although they still recommend Gazprom stock for purchase, Citi analysts downgraded their assessment of the company, interpreting its latest results as an indication of Gazprom's inability to control operational expenses and a sign that growing competition from more efficient competitors could negatively influence the company's profitability in the future. Experts also highlighted a 31 percent spike in Gazprom's net debt, which reflected an increase in long-term borrowing and the revaluation of debt denominated in foreign currency.

-----  
GAZPROM RECEIVES PAYMENT AND WILL NOT IMPOSE FINES  
-----

14. (C) Gazprom received its monthly payment from Ukraine on November 6 despite warnings from Prime Minister Putin that the government of Ukraine might not be able to pay due to the financial instability of Ukrainian state gas company, NaftoGaz. Ivan Zolotov, Gazprom Foreign Relations Department Head, confirmed to us that NaftoGaz had paid in full for October deliveries, noting that Ukraine consumed approximately half of its contracted volume of gas purchases.

MOSCOW 00002765 002 OF 002

15. (C) Russian officials disputed warnings from Ukrainian President Yushchenko regarding the potential for billions of dollars in fines due to Ukraine's failure to purchase the contracted amount of gas. According to media reports, President Yushchenko speculated that Ukraine could be subject to almost USD 8 billion in fines this year because it is unlikely to reach the 40 billion cubic meter contracted volume for 2009 gas purchases. However, Zolotov told us that Russian officials had reached a political decision not to impose any fines due to the "difficult economic and political situation in Ukraine." During a September meeting between Prime Ministers Putin and Timoshenko in Poland, the two informally agreed that Ukraine would only pay for as much gas as it required as long as the "crisis conditions" continued (see reftel).

-----  
COMMENT  
-----

16. (C) Given the historical link between natural gas and oil prices, including the lag before gas prices reflect oil price changes, we expect gas prices to remain soft through the end of this year. Gazprom's European customers are closely tracking these trends when deciding the best point at which to purchase gas to fill their inventories. While purchase volumes may rise through the winter season, the lower price at which customers purchase gas will likely mitigate the financial benefit for Gazprom. The company's leadership appears disinclined to take the deep, structural reforms necessary to improve long-term competitiveness. Gazprom remains focused on meeting the needs of the domestic Russian market and fulfilling "social obligations" to its workforce. Gazprom's gas sales to Ukraine will be a key agenda item at the November 19-20 Russian-Ukrainian Intergovernmental Economic Cooperation Committee meeting between Prime Ministers Putin and Timoshenko in Yalta. We will follow-up to identify any new developments. End Comment.  
Beyrle